Notice of Meeting

Audit & Governance Committee

Date & time	Place	Contact	Chief Executive
Thursday, 7 February 2019 at **10.30 am**	Committee Room C, County Hall, Kingston upon Thames, Surrey KT1 2DN	Joss Butler Room 122, County Hall Tel 020 8541 9702 joss.butler@surreycc.gov.uk	Joanna Killian We're on Twitter: @SCCdemocracy

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This meeting will be held in public. If you would like to attend and you have any special requirements, please contact Joss Butler on 020 8541 9702.

Members

Mr David Harmer (Chairman), Mr Keith Witham (Vice-Chairman), Mr Edward Hawkins, Dr Peter Szanto, Mr Will Forster and Mr Stephen Spence

Ex Officio:

Mr Tim Oliver (Leader of the Council), Mr Colin Kemp (Deputy Leader), Mr Tony Samuels (Chairman of the Council) and Mrs Helyn Clack (Vice-Chairman of the Council)

AGENDA

1 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

2 MINUTES OF THE PREVIOUS MEETING [10/12/18] (Pages 1 - 6)

To agree the minutes as a true record of the meeting.

3 DECLARATIONS OF INTEREST

All Members present are required to declare, at this point in the meeting or as soon as possible thereafter

(i) Any disclosable pecuniary interests and / or

(ii) Other interests arising under the Code of Conduct in respect of any item(s) of business being considered at this meeting

NOTES:

- Members are reminded that they must not participate in any item where they have a disclosable pecuniary interest
- As well as an interest of the Member, this includes any interest, of which the Member is aware, that relates to the Member's spouse or civil partner (or any person with whom the Member is living as a spouse or civil partner)
- Members with a significant personal interest may participate in the discussion and vote on that matter unless that interest could be reasonably regarded as prejudicial.

4 QUESTIONS AND PETITIONS

To receive any questions or petitions.

Notes:

1. The deadline for Member's questions is 12.00pm four working days before the meeting (*1 February 2019)*.
2. The deadline for public questions is seven days before the meeting (*31 January 2019)*.
3. The deadline for petitions was 14 days before the meeting, and no petitions have been received.

5 RECOMMENDATIONS TRACKER (Pages 7 - 10)

To review the Committee's recommendations tracker.

6 TREASURY MANAGEMENT STRATEGY 2019/20 (Pages 11 - 34)

This report sets out the council's treasury management strategy for 2018/19, as required to ensure compliance with CIPFA's Code if Practice for Treasury management.

7 INTERNAL AUDIT PROGRESS REPORT - QUARTER 3 (01/10/18 - 31/12/18) (Pages 35 - 56)

The purpose of this progress report is to inform Members of the work completed by Internal Audit between 1 October 2018 and 31 December 2018.

The original annual plan for Internal Audit is contained within the Internal Audit Strategy and Annual Plan 2018-19, which was approved by Audit and Governance Committee on 12 April 2018.

Along with a regular update on Internal Audit performance, this progress report also includes detail of changes to the annual plan with effect from this quarter to allow for a temporary reduction in the resources available to Internal Audit during the year.

8 DATE OF NEXT MEETING

The next meeting of Audit & Governance Committee will be on 8 April 2019.

Joanna Killian
Chief Executive
Published: 30 January 2019

MOBILE TECHNOLOGY AND FILMING – ACCEPTABLE USE

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MINUTES of the meeting of the **AUDIT & GOVERNANCE COMMITTEE** held at 10.30 am on 12 December 2018 at Members Conference Room, County Hall, Kingston upon Thames, Surrey KT1 2DN.

These minutes are subject to confirmation by the Committee at its next meeting.

Elected Members:
*= in attendance

*Mr David Harmer (Chairman)
*Mr Keith Witham (Vice-Chairman)
*Mr Edward Hawkins
*Dr Peter Szanto
*Mr Will Forster
Mr Stephen Spence

Substitute Members:

Mr Nick Harrison

56/18 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS [Item 1]

Apologies were received from Stephen Spence. Nick Harrison acted as a substitute.

57/18 MINUTES OF THE PREVIOUS MEETING - 27 SEPTEMBER 2018 [Item 2]

The Minutes were approved as an accurate record of the previous meeting.

58/18 DECLARATIONS OF INTEREST [Item 3]

Edward Hawkins declared a non-pecuniary interest in item 8 as he was the Surrey County Council (SCC) appointed Director of Halsey Garton Property Investment Ltd.

59/18 QUESTIONS AND PETITIONS [Item 4]

There were none.

60/18 RECOMMENDATIONS TRACKER [Item 5]

Witnesses:
Mary Lewis, Cabinet Member for Children, Young People and Families
Melanie Harris, School Commissioning Officer

Key points raised during the discussion:

1. In relation to Action A6/18, The Cabinet Member for Children, Young People and Families attended the meeting in order to discuss the Committee’s concerns relating to the decline in revenue for Babcock 4S. The Cabinet Member explained that the Council were gradually reducing work with Babcock 4S due to changes to school improvement works. It was further explained that the Council’s joint

venture with Babcock 4S had provided a dividends that was less than expected due to issues located in Babcock 4S's pensions fund. Members noted that a report which provided further detail was considered by Cabinet earlier in the year. Members further noted that various non-teaching staff, who were previously provided by Babcock 4S, would be transferred within the Council in order to continue providing essential services. Officers confirmed that overall details would be provided to the relevant officers to outline future changes and responsibility arrangements.

2. In regards to Action A16/18, officers confirmed there were ongoing discussions with the Police on this matter and that the situation would continue to me monitored.

RESOLVED:

The Committee noted the report.

61/18 TREASURY MANAGEMENT MID YEAR REPORT [Item 6]

Witnesses:
Nikki O'Connor, Finance Manager

Key points raised during the discussion:

1. Officers introduced the report and provided Members with a brief summary where it was noted that no long term borrowing was undertaken during the first half of 2018/19 and that internal borrowing was maximised and short term borrowing was utilised to manage cash flow. It was also highlighted that operational treasury management work now fell within the remit of the Orbis Centre of Expertise team which included staff who were split over each local authority within Orbis.
2. Members noted that, following County Council agreement on 10 December 2018, approval of the Treasury Management Strategy would now be delegated to the Audit and Governance Committee for consideration. The Strategy would be considered at the Committee's meeting on 7 February 2019 and scrutinised at the Corporate Overview Select Committee meeting on 25 January 2019.
3. Officers informed Members that the resource for internal borrowing was around £400 million.
4. It was noted that, although it was not currently classed as treasury management activities and therefore not covered by the CIPFA Code, the Council also held £77 million of investments in directly owned investment property and £197m in loans to and shareholdings in its subsidiaries.
5. Members discussed the Council's access to liquid assets on a day to day basis where it was noted that, in the current financial climate, it would not be sensible to hold a significant sum of liquid cash due to cost of carry.
6. Members discuss the benefits of investing in money market funds.

Resolved:

The Audit and Governance Committee noted the contents of the Treasury Management Half Year Report for 2018/19.

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62/18 INTERNAL AUDIT PROGRESS REPORT - QUARTER 2 (01/07/18 - 30/09/18) [Item 7]

Witnesses:
Russell Banks, Chief Audit Officer

Key points raised during the discussion:

1. Officers introduced the report and provided Members with a brief summary. It was noted that the report outlined the work completed by Internal Audit between 1 July 2018 and 30 September 2018. It was further noted that there had been some adjustments to the audit plan in order to incorporate absences within the team and resource to support to the Council's transformation programme. The Chief Internal Auditor confirmed he felt comfortable that he would be able to provide an audit opinion at the end of the year.
2. The Committee sought clarification on how Internal Audit intended to support the Council's transformation programme. It was explained that, as the transformation was in an its early stages, Internal Audit would be working initially on specific high level areas of focus. New areas of focus would then be agreed following completion. It was requested that officers update the Committee on focuses of the transformation within the Quarter 3 report. Following further discussion, it was suggested that the Council's various select committee's would be interested in discussing audit findings related to the transformation. It was noted that Select Committee Chairman were notified when audit reports relevant to their remit received a 'high' risk priority indicator.
3. When discussing areas for improvement, it was highlighted that parked invoices of around £30,000 in value were found, the majority of which were in Children's, Families and Learning Directorate. Officers explained that the most likely reason for this was due to a weaknesses the system, or that the system had not being complied with. If the latter, training would be provided to officers to increase compliance.
4. The Committee discussed issues relating to the lack of VAT receipts being attached for fuel purchase, as required by rules set by HM Revenue & Customs (HMRC). Members suggested that officers contact HMRC to investigate the possibility of opting-out of the requirement.
5. Members sought further information on the pension opt-out issue outlined in the Payroll (2017/18) audit summarised in the report. Officers agreed to provide a response outside the meeting.
6. When discussing the Contact Bank Supervisors audit, Members highlighted the £317,000 paid and asked if there was any more context available on the number, particularly in terms of comparison with previous years and other services. Officers agreed to provide a response outside the meeting.

Resolved:

The Audit and Governance Committee noted the report.

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63/18 2017/18 AUDIT FINDINGS REPORT AND ANNUAL STATEMENT OF ACCOUNTS FOR S. E. BUSINESS SERVICES LTD, SURREY CHOICES LTD & HALSEY GARTON PROPERTY LTD [Item 8]

Witnesses:
Susan Smyth, Head of Strategic Finance

Key points raised during the discussion:

1. Officers introduced the report and provided Members with a brief summary. Members noted that Officers were satisfied with the outcome and findings of the external audit of the 2017/18 financial statements of S.E Business Services Ltd, Surrey Choices Ltd and Halsey Garton Property Limited.

Resolved:

The Audit and Governance Committee considered the contents of the 2017/18 Audit Findings Reports of S.E Business Services Ltd, Surrey Choices Ltd and Halsey Garton Property Limited.

64/18 EXTERNAL AUDIT UPDATE REPORT [Item 9]

Witnesses:
Marcus Ward, Grant Thornton
Ciaran McLaughlin, Grant Thornton

Key points raised during the discussion:

1. Representatives introduced the report and provided Members with a brief summary. It was noted that the report included a sector update on matters identified to be relevant to Committee Members.

Resolved:

The Committee noted the external auditor's progress report.

65/18 EXTERNAL AUDIT UPDATE REPORT - SUPPLEMENTARY VALUE FOR MONEY FINDINGS REPORT 2017/18 [Item 10]

Witnesses:
Marcus Ward, Grant Thornton
Ciaran McLaughlin, Grant Thornton

Key points raised during the discussion:

1. Officers introduced the item and provided a brief summary. It was noted that the report was supplementary to the Audit Findings Report issued on 26 July 2018 and was intended to provide further information on the basis of the auditors Value for Money conclusion, which was issued on 28 September 2018. Representatives from Grant Thornton further stated that they were satisfied that the Council was doing everything possible to undertake a robust process to identify and implement its transformation plans.

2. In regards to the summary of findings, Members noted that the external auditors would continue to monitor the outlined recommendations and were confident that the appropriate project management actions were in place.

Resolved:

The Committee noted the external auditor's supplementary report.

66/18 DATE OF NEXT MEETING [Item 11]

The date of the meeting was noted as 7 February 2019.

Meeting ended at: 12.05 pm

Chairman

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SURREY
COUNTY COUNCIL

Audit & Governance Committee
7 February 2019

RECOMMENDATIONS TRACKER

PURPOSE OF REPORT:

For Members to consider and comment on the Committee's recommendations tracker.

INTRODUCTION:

A recommendations tracker recording actions and recommendations from previous meetings is attached as Annex A, and the Committee is asked to review progress on the items listed.

RECOMMENDATION:

The Committee is asked to monitor progress on the implementation of recommendations from previous meetings in Annex A.

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REPORT CONTACT: Joss Butler, Democratic Services Assistant
020 8541 9702 joss.butler@surreycc.gov.uk

Sources/background papers: None

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Annex A

Audit & Governance Committee Recommendations Tracking

Recommendations (ACTIONS)

Number	Meeting Date	Item	Recommendation / Action	Action by whom	Action update
A2/18	22/01/2018	Business Continuity	To discuss timings for future reports once training for Members has taken place on Business Continuity.	Chairman	April 2018 **–** Member Development session titled 'Introduction to Emergency Planning' took place on 30 April 2018. The session provided Members with an overview of the response structures in place for emergency situations, as well as some of the key risks facing both Surrey County Council and local authorities more widely. July 2018 – The Chairman highlighted that he intended to request a report on business continuity and emergency management towards the end of the Council's transformation.
A16/18	26/07/18	Internal Audit & Counter Fraud Annual Report And Opinion 2017-18	Officers agreed to follow up on the Police investigation regarding the misuse of pre-paid credit cards.	Audit Manager	27/09/2018 - the Audit Manager confirmed that he had followed up on the police investigation but had not yet received a full response. 12/12/18 - officers confirmed there were ongoing discussions with the Police on this matter and that the situation would continue to me monitored.

Annex A

Audit & Governance Committee Recommendations Tracking

COMPLETED RECOMMENDATIONS/REFERRALS/ACTIONS – TO BE DELETED

Number	Meeting Date	Item	Recommendation / Action	Action by whom	Action update
A1/18	22/01/2018	Business Continuity	To upload the updated LGA Guidance titled 'A Councillor's guide to Civil emergencies' to the network portal and let all Members know when it's available.	Democratic Services Assistant	Circulated on 15 January 2019 and uploaded to the Member Portal.
A6/18	12/04/2018	Bulletin	To invite the relevant Cabinet Member(s) to a future meeting in order to share concerns and answer questions on Babcock 4S.	Democratic Services Assistant	Action completed at Committee meeting on 12 December 2018. Details can be found within the meeting's minutes.

SURREY
COUNTY COUNCIL

Audit & Governance Committee
7 February 2019

Treasury Management Strategy 2019/20

Purpose of the report:
This report sets out the council's treasury management strategy for 2018/19, as required to ensure compliance with CIPFA's Code of Practice for Treasury management.

Recommendations:

The Audit and Governance Committee is asked to approve the Treasury Management Strategy for 2019/20.

Introduction:

1. At the Council meeting on 11 December 2018 it was agreed that responsibility for approving the annual Treasury Management Strategy Statement (TMSS) should be delegated to the Audit and Governance Committee. The Council Overview Scrutiny Committee provided scrutiny of this strategy on 25 January 2019.

2. The Council's Treasury Management Strategy for 2019/20 is attached as Annex 1.

Treasury Management Strategy 2019/20:

3. Treasury management is defined as 'the management of the organisation's cash flows, banking, money market and capital market transactions, the effective management of the risks associated with those activities, and the pursuit of optimum performance consistent with those risks.'[1]

4. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risks are therefore central to the Authority's prudent financial management.

5. The proposed TMSS shows the Authority's risk appetite and limits for investment and borrowing, and the full set of Prudential and Treasury Indicators.

[1] CIPFA Code of Practice for Treasury Management in the Public Services.

Implications:

Financial and value for money implications

1. The impact of this strategy on the interest paid and interest receivable budgets are included within paragraph 65 of annex 1 and have also been factored into the Medium Term Financial planning for 2019/20.

Equalities and Diversity Implications

2. There are no direct equalities implications of this report.

Risk Management Implications

3. The Authority measures and manages its exposures to treasury management risks using indicators outlined in paragraphs 54-60 of annex 1.

Next Steps:

4. The Treasury Team will monitor borrowing and cash investments and will continue to update this Committee as appropriate.
5. A half-year monitoring report and full-year report for 2019/20 will be presented to this committee.

Report contact: Nikki O'Connor, Finance Manager (Assets & Accounting)

Contact Details: Nicola.oconnor@surreycc.gov.uk 020 8541 9263

Sources/Background Papers: CIPFA Code of Practice for Treasury Management in the Public Services (Revised)

Treasury Management Strategy Statement 2019/20

Introduction

1 Treasury management at Surrey County Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year.

2 In addition, the Ministry of Housing, Communities and Local Government (MHCLG) issued revised Statutory Guidance on Local Government Investment in February 2018. The new requirements of the MHCLG Investment Guidance are covered in the Council's Capital and Investment Strategy, which will be considered by Council on 5 February.

3 This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code. A full set of Prudential Indicators and Treasury Indicators are set out in Annex 1.

4 Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Authority's prudent financial management.

5 Investments held for service purposes or for commercial profit are considered in the Capital and Investment Strategy and therefore this strategy relates solely to borrowing and investments undertaken as part of the daily treasury management activities.

External Context

6 **Economic background**: The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2019/20.

7 The rise in quarterly GDP growth to 0.6% in Q3 from 0.4% in the previous quarter was due to weather-related factors boosting overall household consumption and construction activity over the summer following the weather-related weakness in Q1.

8 In November 2018, the MPC maintained Bank Rate at 0.75% while the Inflation Report showed that compared to the August report further interest rate increases may be required to bring inflation down to the 2% target over the forecast horizon.

9 UK Consumer Price Inflation (CPI) for November was up 2.3% year/year, broadly in line with the Bank of England's November Inflation Report.

10 **Credit outlook:** The big four UK banking groups have now divided their retail and investment banking divisions into separate legal entities under ringfencing legislation. Bank

of Scotland, Barclays Bank UK, HSBC UK Bank, Lloyds Bank, National Westminster Bank, Royal Bank of Scotland and Ulster Bank are the ringfenced banks that now only conduct lower risk retail banking activities. Barclays Bank, HSBC Bank, Lloyds Bank Corporate Markets and NatWest Markets are the investment banks. Credit rating agencies have adjusted the ratings of some of these banks with the ringfenced banks generally being better rated than their non-ringfenced counterparts.

Interest rate forecast:

11 Following the increase in Bank Rate to 0.75% in August 2018, the Authority's treasury management adviser Arlingclose is forecasting two more 0.25% hikes during 2019 to take official UK interest rates to 1.25% by the end of the year. The Bank of England's MPC has maintained expectations for slow and steady rate rises over the forecast horizon.

12 Gilt yields and hence long-term borrowing rates have remained at low levels but some upward movement from current levels is expected.

13 A more detailed economic and interest rate forecast provided by Arlingclose is attached at **Annex 2**.

14 For the purpose of setting the budget for 2019/20, it has been assumed that new investments will be made at an average rate of 0.75%, and that new short-term loans will be borrowed at an average rate of 1.0%

Local Context:

15 On 31 December 2018 the Authority held £711m of short and long-term borrowing and £17m of investments. This is set out in further detail in **Annex 3**.

16 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. Internal borrowing allows the Council to utilise its internal cash balances (i.e. working capital and reserves) which are not required in the short to medium term in order to reduce risk and keep interest costs low.

17 Forecast changes in these sums are shown in the balance sheet analysis in Table 1 below.

Table 1: Balance sheet summary and forecast

	31.3.18 Actual £m	**31.3.19 Estimate £m**	**31.3.20 Forecast £m**	**31.3.21 Forecast £m**	**31.3.22 Forecast £m**	**31.3.23 Forecast £m**	**31.3.24 Forecast £m**
General Fund CFR	1,152	1,267	1,303	1,317	1,337	1,332	1,325
Less: PFI liabilities	-181	-205	-198	-191	-184	-176	-168
Net CFR (underlying need to borrow)	**971**	**1,062**	**1,105**	**1,126**	**1,153**	**1,156**	**1,157**
Less: External	-397	-397	-397	-397	-397	-387	-387

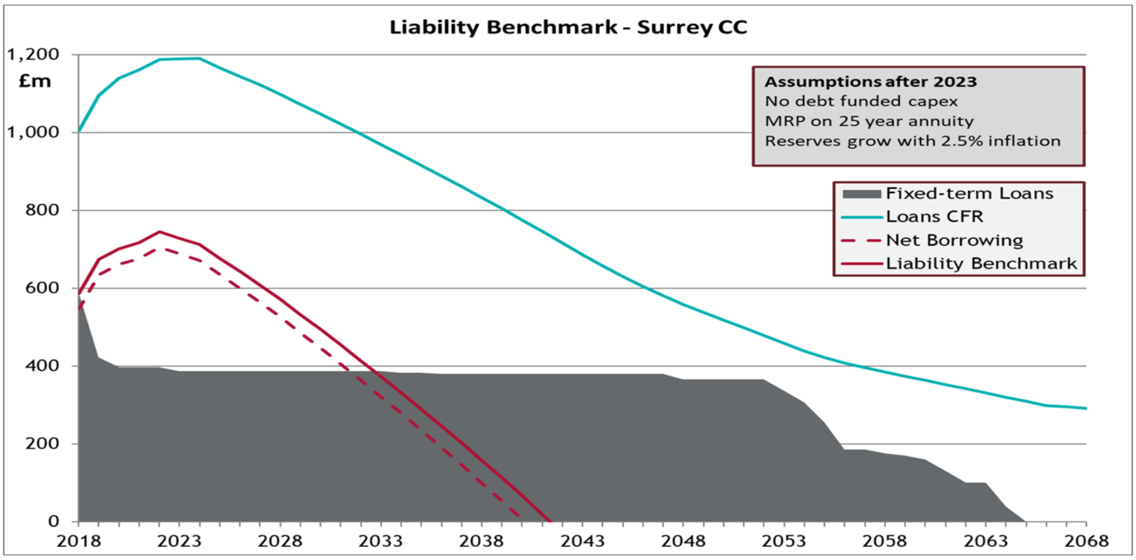
borrowing (long term)							
Internal borrowing (based on projection of level of reserves, balances and working capital)	-381	-373	-389	-394	-394	-413	-422
Projected additional external borrowing requirement	**193**	**292**	**319**	**335**	**362**	**356**	**348**

17 The Authority has an increasing CFR over the period to 31 March 2022, due to the proposed capital programme and approved investment strategy projects. The maximisation of internal borrowing leads to a borrowing requirement above the Council's ability to utilise its internal resources to fund this capital expenditure. It will therefore be required to raise additional external borrowing over the forecast period.

18 CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2019/20.

19 To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the Council's projected treasury management position over the next 50 years.

Graph 1: Liability benchmark



20 The long-term liability benchmark assumes:

- Capital expenditure funded by borrowing as per the 2019/24 capital programme
- Only projects approved and included in the Capital Programme and approved investment strategy spend are currently included
- Minimum Revenue Provision (MRP) on new capital expenditure is based on the existing MRP policy
- Reserves and Balances are based on proposed and approved use over the life of the MTFP and increasing by inflation of 2.5% a year.

6

21 As illustrated in the graph above, the difference between the CFR (underlying need to borrow) and actual external borrowing is funded from Reserves and Balances (internal borrowing). The current strategy to internally borrow continues to support the Council's financial position in the short to medium term.

22 As shown, the Council's current debt portfolio is long dated and there are no significant repayments until the 2050's.

Borrowing Strategy

23 The Authority is projected to have £689m of borrowing as at the end of March 2019, an increase of £80m since the 31 March 2018. The increase relates to short term borrowing, which changes to reflect the changing cash flow requirements. Financial year end is historically the low point for cash levels, with government grants received early in the financial year, ahead of spend. Long term borrowing remains at £397m. There is no change from the previous year, as no additional long term borrowing has been undertaken or repaid.

24 **Objectives:** The Authority's main objective when borrowing money is to strike an appropriate balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required.

25 **Strategy**: The Council is facing unprecedented financial pressures, principally driven by rising need for services from residents and continuing reductions in government funding. Given these pressures, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, the Authority continues to maximise the use of internal resources (internal borrowing) and borrowing short term to fund the additional requirement based on cash flow forecasts.

26 By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce market and credit risk in the investment portfolio. However, short term borrowing does increase the Authority's exposure to changes in interest rates as when short term loans mature they may need to be replaced and a higher rate of interest. The level of internal / short term borrowing will be reviewed on a regular basis, taking account of the overall cash position and market forecasts. Arlingclose will assist in this review with 'cost of carry' and breakeven analysis, which will support decisions on whether to take additional longer term external borrowing at fixed rates in 2019/20, with a view to keeping future interest costs low.

27 Alternatively, the Authority may arrange forward starting loans where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost without suffering a cost of carry in the intervening period.

28 **Sources of borrowing:** The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB) and any successor body
- any institution approved for investments (see below)

- banks or building societies authorised to operate in the UK
- UK local authorities
- UK public and private sector pension funds (except the Surrey Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues.

29 The Authority has previously raised the majority of its long term borrowing from the PWLB. For short term borrowing, the Council has, and will continue, to use other sources of finance, such as loans from other local authorities, pension funds and other public bodies as these are often available at more favourable rates. These short term loans leave the Authority exposed to the risk of interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below.

30 **Other sources of debt finance:** In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative (PFI)
- sale and leaseback

All such sources of finance are subject to a robust options appraisal.

31 **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a joint and several guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report.

32 **Debt rescheduling:** The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

Investment Strategy

33 The Authority holds invested funds representing income received in advance of expenditure plus reserves. Since 1 April 2018, the Authority held average balances of £39m, compared to with £69m over 2017/18. The average returns of 0.58%. Cash balances are expected to remain low during 2019/20.

34 **Objectives:** The CIPFA Code requires the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

35 **Negative interest rates:** If the UK enters into a recession in 2019/20, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

36 **Strategy:** Due to the continuation of the strategy to maximise internal borrowing and use short term borrowing to manage cash flow shortfalls, investment levels are expected to remain low during 2019/20. The majority of the Authority's surplus cash continues to be invested in money market funds and short-term unsecured bank deposits. Money Market Funds offer same-day liquidity, very low or no volatility and also ensure diversification to reduce the security risk of holding the majority of cash deposits with a limited number of UK banks.

37 While the Council's investment balances remain low (less than £100m), Money Market Funds and short term bank deposits will be utilised, with a cash limit per counterparty/fund of £25m. If the economic situation changes, which results in a decision to undertake additional borrowing, resulting in higher cash balances, other investment counterparties may be considered and the counterparty limits set out below would apply.

38 **Business models**: Under the new International Financial Reporting Standard (IFRS) 9 standard, the accounting for certain investments depends on the Authority's "business model" for managing them. The new standard requires entities to account for expected credit losses in a timely manner; from the moment when financial instruments are first identified. These investments will continue to be accounted for at amortised cost.

39 **Approved counterparties**: The Authority may invest its surplus funds with any of the counterparty types in Table 2 below, subject to the cash limits (per counterparty) and the time limits shown.

40 Table 2: Approved investment counterparties and limits

Credit rating	**Banks unsecured**	**Banks secured**	**Government***
UK Govt	n/a	n/a	£ Unlimited 50 years
AAA	£10m 5 years	£20m 20 years	n/a
AA+	£10m 5 years	£20m 10 years	n/a
AA	£10m 4 years	£20m 5 years	n/a
AA-	£10m 3 years	£20m 4 years	n/a
A+	£10m 2 years	£20m 3 years	n/a
A	£10m 13 months	£20m 2 years	n/a
A-	£10m 6 months	£20m 13 months	n/a
None	£1m 6 months	n/a	**n/a**
Pooled Funds	£25m per fund		

* UK local authorities

This table must be read in conjunction with the notes below

41 **Credit rating:** Investment limits are set by reference to the lowest published long-term credit rating from Fitch, Moody's and Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

42 **Banks unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail.

43 **Banks secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

44 **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

45 **Pooled funds:** Shares or units in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

46 Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

47 **Operational bank accounts:** The Authority may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £1m. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity. The Authority's bank, HSBC, has a credit rating of AA-.

48 **Risk assessment and credit ratings**: Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

49 Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

50 **Other information on the security of investments**: The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis. No investments will be made with an organisation if there are substantive doubts about its credit quality.

51 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested. In the event of a "no deal Brexit", the Authority has the ability to invest in UK based MMFs (Federated and CCLA) and with the Debt Management Officer (DMO), which is in effect a direct investment with the UK Government.

52 **Investment limits**: The Authority's revenue reserves and balances available to cover investment losses are forecast to be approximately £65m on 31st March 2019. In order that no more than 30% of available reserves will be put at risk in the case of a single default, the maximum that will be invested with any one organisation (other than the UK Government) will be £20m and the limit for any one pooled fund will be £25m.

Table 3: Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£20m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£20m per group
Any group of pooled funds under the same management	£25m per manager
Money Market Funds	£125m in total
Unsecured investments with Building Societies	10m in total

53 **Liquidity management**: The Authority uses cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium-term financial plan and cash flow forecast.

Treasury Management Indicators

54 The Authority measures and manages its exposures to treasury management risks using the following indicators.

55 **Security:** The Authority has adopted a voluntary measure of exposure to credit risk by monitoring the value-weighted average default rates of its investment portfolio. This is calculated by taking the historic risk of default rate, weighted by the size of each investment and calculating a portfolio average. Unrated investments are assigned a score based on their perceived risk.

	Maximum Exposure
Portfolio average historic risk of default rate	0.05%

56 **Liquidity:** The Authority has adopted a voluntary measure of exposure to liquidity risk by monitoring the amount it can borrow over an average month without giving prior notice. During December 2018, a total of £180m was sourced from other local authorities for short term periods. During 2018 the Council has never been overdrawn due to a failure to find funding. The intra local authority borrowing/lending market has remained a reliable source of short term funding, and should remain so for the foreseeable future.

57 **Interest rate exposures**: This indicator is set to limit the Authority's exposure to interest rate risk by assessing the impact of a 1% rise or fall in interest rates will be, based upon an average short term borrowing of £195m.

Interest rate risk indicator	**Limit**
Revenue impact of a 1% movement in interest rates	+/- £1.95m

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

58 **Maturity structure of borrowing:** This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	**Upper limit**	**Lower limit**
Under 12 months	60%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and above	100%	25%

59 Time periods start on the first day of each financial year. The maturity date of borrowing is the date of the loans are due to be repaid.

60 **Principal sums invested for periods longer than 1 year:** The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment

of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Price risk indicator	2019/20	2020/21	2021/22
Limit on principal invested beyond year end	£40m	£20m	£10m

Other Items

61 There are a number of additional items that the Authority is obliged by CIPFA of the MHCLG to include in its treasury management strategy.

62 **Policy on the use of Financial Derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

63 The Authority will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

64 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

65 **Markets in Financial Instruments Directive**: The Authority has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, the Section 151 Officer believes this to be the most appropriate status.

66 **Treasury Management Advice:** Surrey County Council has appointed Arlingclose Limited as Treasury management advisers and receives specific advice on investments, debt and capital finance matters.

67 **Treasury Management Training**: Member and Officer training needs are assessed regularly as part of the staff appraisal process. Additional training will be provided as and when there is a change in roles and responsibilities. The Authority also benefits from the Orbis partnership Centre of Expertise, which provides a robust Treasury team providing day to day treasury management operational activities to Surrey County Council, Brighton & Hove City Council and East Sussex County Council.

Financial Implications

65 The budget for investment income in 2019/20 is £300,000, based on an average investment portfolio of £40m at an interest rate of 0.75%. The budget for debt interest paid in 2019/20 is £19m, which is based on a mix of short term borrowing (average level of £260m at an average interest rate of 1%) and the existing long term fixed rate debt portfolio.

66 The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Section 151 Officer believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller

Prudential and Treasury Indicators 2019/20

1. The Local Government Act 2003 requires the Authority to have regard to the Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

2. The Council has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice.

Estimates of capital expenditure

3. The Authority's planned capital expenditure and financing is summarised in table 1. This prudential indicator is a summary of the Council's annual capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

Table 1: Actual and estimated capital expenditure

	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
	Actual	Projected	← ----------	----------	Estimated	----------	---------- →
	£m	£m	£m	£m	£m	£m	£m
Capital programme expenditure	108	137	129	93	76	58	57
Approved investment strategy spend	103	113	13	7	15	0	0
Financed By:							
- Government grants	98	84	67	50	32	32	32
- Revenue, reserves & third party contributions	1	32	17	12	12	3	3
Net financing need for the year*	**112**	**135**	**59**	**38**	**46**	**22**	**21**

*Capital expenditure to be met by borrowing

The Council's borrowing need (the capital financing requirement)

4. Table 2 sets out the Council's estimated capital financing requirement (CFR). The CFR represents capital expenditure funded by external debt and internal borrowing and not by capital receipts, revenue contributions, capital grants or third party contributions at the time of spending. The CFR thus measures an authority's underlying need to borrow for a capital purpose. Any capital expenditure which has not been funded from locally determined resources will increase the CFR. The CFR will reduce by the minimum revenue provision (MRP).

5. The MRP is a statutory annual revenue charge which reduces the borrowing need in a similar way to paying principal off a household mortgage.

6. The CFR includes any other long term liabilities, e.g., PFI schemes, finance leases. Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes and they therefore do not form part of the Council's underlying need to borrow.

Table 2: Capital Financing Requirement (CFR)

	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
	Actual	Projected	← ----------------------		Estimated		---------------------- →
	£m	£m	£m	£m	£m	£m	£m
Opening CFR	1,061	1,152	1,267	1,303	1,317	1,337	1,332
Movements:							
- Minimum revenue provision	-24	-21	-21	-23	-25	-26	-27
- Application of capital receipts	-28	-29	0	0	0	0	0
- PFI & finance leases	32	30	-1	-1	-1	-1	-1
- Net financing need	112	135	59	38	46	22	21
	91	115	37	14	20	-5	-7
Closing CFR	**1,152**	**1,267**	**1,303**	**1,317**	**1,337**	**1,332**	**1,325**

*includes the addition to fixed assets on the balance sheet under PFI

7. The CFR is forecast to rise over the next 3 years, as capital expenditure plans financed by borrowing outweighs the resources planned to be set aside for debt repayment (MRP).

Gross borrowing and the capital financing requirement

8. In order to ensure that over the medium term borrowing will only be for a capital purpose, the Council should ensure that its debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current and next 2 financial years. This allows some flexibility for early borrowing in advance of need, but ensures that borrowing is not undertaken for revenue purposes. This is a key indicator of prudence.

Table 3: Gross Borrowing Requirement

	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
	Actual	Projected	← -------------------		Estimated		------------------- →
	£m	£m	£m	£m	£m	£m	£m
Gross Borrowing	590	689	716	732	759	743	736
CFR	1,152	1,267	1,303	1,317	1,337	1,332	1,325

9. Total debt is expected to remain below the CFR during the forecast period.

The Council's operational boundary for external debt

10. Table 4 sets out the Council's operational boundary. The operational boundary is an indicator against which to monitor its external debt position. It is based on the Authority's estimate of the most likely (ie prudent but not worst case) scenario for external debt. It links directly to the Authority's estimates of capital expenditure, the CFR and cash flow requirements and is a key management to for in-year monitoring.

11. Within the operational boundary, figures for borrowing and other long-term liabilities are separately identified. Other long-term liabilities comprise finance lease, PFIs and other liabilities that are not borrowing but form part of the Authority's debt position.

12. The operational boundary is not a limit and actual borrowing could vary around this boundary for short periods during the year. It should act as an indicator to ensure the authorised limit is not breached.

Table 4: Operational Boundary

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
	Agreed	← -------------------		Estimated		------------------- →
	£m	£m	£m	£m	£m	£m
Borrowing	702	966	1131	1179	1173	1166
Other long term liabilities	170	143	124	106	87	68
Total	**872**	**1108**	**1256**	**1285**	**1260**	**1234**
Estimated external debt	689	716	732	759	743	736

<u>The Council's authorised limit for external debt</u>

13. Table 5 sets out the Council's authorised limit for external debt. This key prudential indicator represents a control on the maximum level of borrowing. It is a statutory limit determined under section 3(1) of the Local Government Act 2003 and represents a limit beyond which external debt is prohibited. It is the maximum amount of debt that the Authority can legally owe.

14. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised since the introduction of the Prudential Code.

15. The Authorised limit provides headroom over and above the operational boundary for unusual cash movements and potential additional borrowing to meet the ambitions of the Council in respect of its investment strategy.

16. As with the operational boundary, the limit separately identifies borrowing from other long term liabilities such as finance leases and PFIs.

Table 5: Authorised Limit						
	2018/19	**2019/20**	**2020/21**	**2021/22**	**2022/23**	**2023/24**
	Agreed	**← ---------------------**		**Estimated**	**--------------------- →**	
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Borrowing	1,092	1,553	1,717	1,757	1,762	1,755
Other long term liabilities	182	143	124	106	87	68
Total	**1274**	**1696**	**1841**	**1863**	**1849**	**1823**
Estimated external debt	689	716	732	759	743	736

Estimated ratio of financing costs to net revenue stream

17. This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Table 6: Ratio of Financing Costs to Net Revenue Stream

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
	Projected	← --------------------	-------------------- Estimated	--------------------	--------------------	→
Ratio of Financing Costs to Net Revenue Stream	2.02%	1.55%	1.75%	1.89%	2.02%	2.07%

18. The revenue implications of potential, yet to be identified, investment opportunities that meet the Council's long term capital strategy criteria, will be funded from the investment returns of such investments. If there is a delay in the realisation of sufficient returns then costs will be funded from the Council's Revolving Infrastructure & Investment Fund.

Treasury Indicators:

Principal sums invested for periods longer than a year (including shares, which is the only remaining limit for non-specified investment)

Price risk indicator	2019/20	2020/21	2021/22
Limit on principal invested beyond year end	£40m	£20m	£10m

Refinancing risk - Maturity structure of borrowing

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	60%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and above	100%	25%

Interest rate risk.

Interest rate risk indicator	Limit
Upper limit on one-year revenue impact of a 1% rise in interest rates	£1,95m
Upper limit on one-year revenue impact of a 1% fall in interest rates	-£1.95m

Portfolio average credit rating or credit score.

	Maximum Exposure
Portfolio average historic risk of default rate	0.05%

6

Liquidity

Liquidity risk indicator	Target
Total sum required in December without prior notice	£180m
Total sum borrowed in December	£180m

Arlingclose Economic & Interest Rate Forecast December 2018

Underlying assumptions:

- Our central interest rate forecasts are predicated on there being a transitionary period following the UK's official exit from the EU.

- The MPC has a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. We believe that MPC members consider that: 1) tight labour markets will prompt inflationary pressure in the future, 2) ultra-low interest rates result in other economic problems, and 3) higher Bank Rate will be a more effective policy weapon if downside risks to growth crystallise.

- Both our projected outlook and the increase in the magnitude of political and economic risks facing the UK economy means we maintain the significant downside risks to our forecasts, despite the potential for slightly stronger growth next year as business investment rebounds should the EU Withdrawal Agreement be approved. The potential for severe economic outcomes has increased following the poor reception of the Withdrawal Agreement by MPs. We expect the Bank of England to hold at or reduce interest rates from current levels if Brexit risks materialise.

- The UK economic environment is relatively soft, despite seemingly strong labour market data. GDP growth recovered somewhat in the middle quarters of 2018, but more recent data suggests the economy slowed markedly in Q4. Our view is that the UK economy still faces a challenging outlook as the country exits the European Union and Eurozone economic growth softens.

- Cost pressures are easing but inflation is forecast to remain above the Bank's 2% target through most of the forecast period. Lower oil prices have reduced inflationary pressure, but the tight labour market and decline in the value of sterling means inflation may remain above target for longer than expected.

- Global economic growth is slowing. Despite slower growth, the European Central Bank is conditioning markets for the end of QE, the timing of the first rate hike (2019) and their path thereafter. More recent US data has placed pressure on the Federal Reserve to reduce the pace of monetary tightening – previous hikes and heightened expectations will, however, slow economic growth.

- Central bank actions and geopolitical risks have and will continue to produce significant volatility in financial markets, including bond markets.

Forecast:

- The MPC has maintained expectations of a slow rise in interest rates over the forecast horizon, but recent events around Brexit have dampened interest rate expectations. Our central case is for Bank Rate to rise twice in 2019, after the UK exits the EU. The risks are weighted to the downside.

6

- Gilt yields have remained at low levels. We expect some upward movement from current levels based on our central case that the UK will enter a transitionary period following its EU exit in March 2019. However, our projected weak economic outlook and volatility arising from both economic and political events will continue to offer borrowing opportunities.

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.17**
Arlingclose Central Case	**0.75**	**1.00**	**1.00**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.17**
Downside risk	0.00	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	**0.65**
3-mth money market rate														
Upside risk	0.10	0.10	0.10	0.10	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	**0.17**
Arlingclose Central Case	**0.80**	**1.00**	**1.10**	**1.20**	**1.30**	**1.30**	**1.25**	**1.20**	**1.20**	**1.20**	**1.20**	**1.20**	**1.20**	**1.17**
Downside risk	0.20	0.50	0.60	0.70	0.80	0.80	0.75	0.75	0.75	0.75	0.75	0.75	0.75	**0.68**
1-yr money market rate														
Upside risk	0.20	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.33**
Arlingclose Central Case	**1.05**	**1.25**	**1.35**	**1.40**	**1.50**	**1.45**	**1.40**	**1.40**	**1.40**	**1.40**	**1.40**	**1.40**	**1.40**	**1.37**
Downside risk	0.35	0.50	0.60	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	**0.69**
5-yr gilt yield														
Upside risk	0.15	0.20	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.32**
Arlingclose Central Case	**1.15**	**1.20**	**1.25**	**1.35**	**1.40**	**1.40**	**1.35**	**1.35**	**1.30**	**1.30**	**1.30**	**1.30**	**1.30**	**1.30**
Downside risk	0.30	0.35	0.45	0.50	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	**0.54**
10-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.32**
Arlingclose Central Case	**1.60**	**1.65**	**1.65**	**1.70**	**1.75**	**1.75**	**1.75**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**
Downside risk	0.30	0.45	0.50	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	**0.55**
20-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.32**
Arlingclose Central Case	**1.90**	**1.95**	**1.95**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**1.98**
Downside risk	0.30	0.40	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	**0.43**
50-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.32**
Arlingclose Central Case	**1.80**	**1.85**	**1.85**	**1.90**	**1.90**	**1.90**	**1.90**	**1.90**	**1.90**	**1.90**	**1.90**	**1.90**	**1.90**	**1.88**
Downside risk	0.30	0.40	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	**0.43**

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
PWLB Local Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Investment & Debt Portfolio Position as at 31 March 2018

	Actual Portfolio £m	Average Rate %
External borrowing:		
Public Works Loan Board	387	4.60
Market	10	5.00
Local authorities	211	0.48
Total external borrowing	**608**	
Other long-term liabilities:		
Private Finance Initiative	181	
Total other long-term liabilities	**181**	
Total gross external debt	**687**	
Treasury investments:		
Banks & building societies (unsecured)	-	
Government (incl. local authorities)	-	
Money Market Funds	43	0.21
Total treasury investments	43	
Net debt	**644**	

Glossary of Terms

CCLA – Churches, Charities and Local Authorities

CFR – Capital Financing Requirement

CIPFA – Chartered Institute of Public Finance Accountancy

CPI – Consumer Price Index

DMO – Debt Management Office

DMADF – Debt Management Account Deposit Facility

ECB – European Central Bank

GDP – Gross Domestic Product

MHCLG – Ministry of Housing, Communities and Local Government

MiFID - Markets in Financial Instruments Directive

MMF – Money Market Fund

MPC – Monetary Policy Committee

MRP – Minimum Revenue Provision

PWLB – Public Works Loan Board

TMPs – Treasury Management Practices

TMPS – Treasury Management Policy Statement

TMSS – Treasury Management Strategy Statement

AUDIT & GOVERNANCE COMMITTEE
7 February 2019

Internal Audit Progress Report – Quarter 3 (01/10/18 – 31/12/18)

SUMMARY AND PURPOSE:

The purpose of this progress report is to inform Members of the work completed by Internal Audit between 1 October 2018 and 31 December 2018.

The original annual plan for Internal Audit is contained within the Internal Audit Strategy and Annual Plan 2018-19, which was approved by Audit and Governance Committee on 12 April 2018.

Along with a regular update on Internal Audit performance, this progress report also includes detail of changes to the annual plan with effect from this quarter to allow for a temporary reduction in the resources available to Internal Audit during the year.

RECOMMENDATIONS:

The Audit and Governance Committee is asked to note the report and consider any further action required in the response to issues raised.

BACKGROUND:

1. Key audit findings from final reports issued during Quarter 3 are summarised in Appendix A.

2. Reviews completed in this quarter included a mixture of planned and unplanned audits, grant certification work, and irregularity work. Overall, of the nine formal audits finalised during the quarter (excluding grant and irregularities), one received ‘substantial assurance’, four received ‘reasonable assurance’, three were given partial assurance and one received ‘minimal assurance’.

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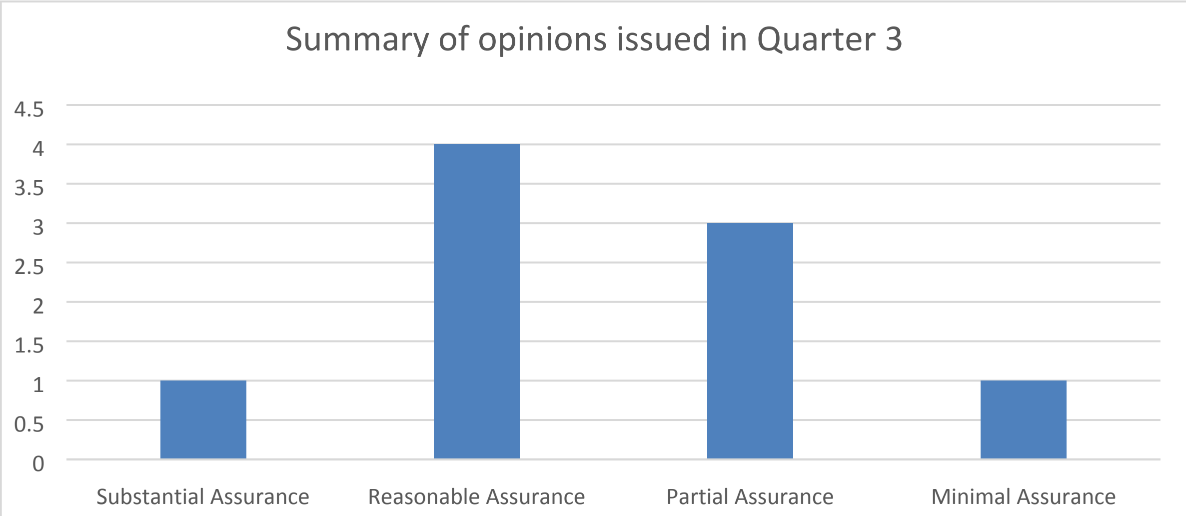

3. Formal follow up reviews continue to be carried out for all audits where ‘minimal assurance’ opinions have been given and for higher risk areas receiving ‘partial assurance’. One follow-up review of ‘Non-Maintained Independent School Placement Management’ was completed in the quarter: this resulted in an opinion being revised from partial assurance to reasonable assurance following progress against agreed actions being implemented as expected.

4. Members will recall that flexibility was built into the audit plan to allow resources to be directed to any new and emerging risks. We continue to liaise with departments to identify these, and also bring them to the attention of the Corporate Leadership Team. Details of those reviews added and removed from the plan so far this year are set out at the end of Appendix A.

5. Appendix A also provides details of counter fraud investigations completed, information on the tracking of high priority actions and progress against our performance targets.

IMPLICATIONS:

6. Financial;
Equalities;
Risk management; and/or
Value for money

7. There are no direct implications (relating to finance, equalities, risk management or value for money) arising from this report. Any such matters highlighted as part of the audit work referred to in this report, would be progressed through the agreed Internal Audit Reporting and Escalation Policy

WHAT HAPPENS NEXT:

8. See Recommendations above.

REPORT AUTHOR: **Russell Banks, Orbis Chief Internal Auditor**
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Sources/background papers: Internal Audit Strategy and Annual Audit Plan 2018/19.

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Appendix A

Internal Audit and Counter Fraud

Quarter 3 - Progress Report 2018/19

CONTENTS

Surrey County Council

Brighton & Hove City Council

East Sussex County Council

SURREY

1. Summary of Completed Audits

Non Maintained Independent School Placement Management – follow up

1.1 Surrey County Council (SCC) has a responsibility to provide extra help to children assessed as having special educational needs and disabilities (SEND). For those with severe and complex needs, an Education Health and Care Plan (EHCP) is raised. As at August 2018, SCC has 8,521 children and young people with an EHCP.

1.2. Where there is not enough SEND provision in SCC maintained schools, or in complex cases, or following a tribunal, then children are placed in non-maintained independent schools (NMIs) and fees are fully or partially-funded by SCC. As at May 2017, 853 NMI places were funded or part-funded by SCC with a projected full year cost of £38.16m, an average of £44,736 per pupil.

1.3 The previous audit opinion following the original review of this area in November 2017 was of Partial Assurance over the controls in place.

1.4 Our follow-up audit identified that eight of the ten actions have now been implemented within the agreed timescale. The need to establish and implement an improved process for evidencing the justification of NMI placement, making more transparent the search activity, selection decision and cost, had not been completed by the agreed date of December 2017.

1.5 However, we identified that a new robust system had been implemented since March 2018. An NMI moderation panel meets every 2 weeks to review evidence for the justification of NMI placement, the search activity, the selection decision, the comparative costs, and any other relevant factors.

1.6 Overall, given the improvement in control evidenced during this audit, we were able to raise the level of assurance given to that of **Reasonable Assurance**.

SAP Application Controls

1.7 Our review of SAP Application Controls has assessed the adequacy and effectiveness of access restriction mechanisms to a variety of sensitive transactions in SAP as well as evaluating key controls in relation to the accuracy and integrity of data processed within the system.

1.8 The SAP system is the Council's key software system for its financial management, budgeting and reporting functions, payments to employees, suppliers and billing of revenue. There are also a number of additional modules in use such as Enterprise Resource Planning (ERP), Supplier Relationship Management (SRM) and Business Information Warehouse (BIW).

1.9 The purpose of the audit was to provide assurance that controls were in place to meet the following key objectives:

- System access is restricted to appropriately authorised individuals and the permissions provided to those users are in line with job functions;
- Data processed through interfaces is authorised, accurate, complete, securely processed and written to the appropriate file;
- Outputs produced by the system are complete, accurate, reliable, distributed on time and with confidentiality where appropriate;
- System updates and enhancements are performed in a consistent manner and subject to sufficient testing and authorisation before implementation;
- Appropriate support arrangements are in place to manage changes within the system.

1.10 We were able to provide **Reasonable Assurance** over the controls operating within the area under review because we found evidence of robust controls over user permissions being linked to roles; over the accuracy, completeness and validity of interfaced data; and over system updates being introduced in a controlled manner.

1.11 However, a number of control weaknesses were identified that, once resolved, will improve the overall control environment. These included controls over user access permissions; over the assignment of roles; and over the change request process.

1.12 In response to these findings, a range of remedial actions have been agreed with management as part of a set of agreed actions.

Pension Fund Investments

1.13 Surrey County Council (SCC) has a statutory responsibility to administer and manage the Surrey Pension Fund on behalf of all participating employees from the Council and other partner organisations. The primary objective of the fund is to ensure that assets are managed for the long term benefit of scheme members in accordance with the rules of the scheme and the regulatory framework (including statute) and to maximise the Fund's growth while minimising the investment risk. The latest actuarial valuation of the fund as at 31st March 2016 reported assets of £3,213m against liabilities of £3,892m resulting in a funding level of 83%.

1.14 The purpose of the audit, which is an annual review undertaken as part of our Key Financial Systems work, was to provide assurance that controls are in place to meet the following key objectives:

- that the fund has a suitable statement of objectives which is linked to measurable targets and performance indicators;
- To ensure that the fund's investment strategy is robust and strategic decisions are implemented correctly and in a timely manner;
- To ensure monitoring arrangements over the fund and fund managers are significantly robust; and
- To provide assurance over the internal control environment in which the fund managers and custodians operate.

1.15 Our audit was able to provide assurance that appropriate governance arrangements were in place around the Surrey Local Pension Board, and that key controls were operating as expected in fund management in such areas as drawing down funds for investment, the management of investment and subsequent dividend income, and in the maintenance of a complete risk register.

1.16 We recommended a small number of improvements to management, including that the service finalise a new approach to the reconciliation of data between Northern Trust reports and SAP, (this remained unreconciled at the time the audit was being concluded). We noted that whilst the current investment strategy is compliant with the requirements of the Local Government Pension Regulations, testing identified that investments at the time of the audit slightly exceeded the council's stated Allocations Policy in some categories.

1.17 Overall, based on these findings being agreed with management, we were able to provide an overall opinion of **Reasonable Assurance** over the key controls in place.

Looked After Children Initial Health Assessments

1.18 There is a statutory requirement that all newly Looked After Children undertake an Initial Health Assessment (IHA). This must be completed and the resulting written report received by Children's Services within 20 working days of the child's first day in the council's care. Performance against this target is currently poor and has been subject to criticism by OFSTED, including in their recent re-inspection report of May 2018.

1.19 We were invited to review this area by Children's Services management, with an agreed scope to seek independent assurance that:

- All newly Looked After Children receive an Initial Health Assessment within the statutory timescales;
- Reported performance data is accurate; and
- Data is shared effectively between Children's Services, the CCG and provider.

1.20 We were only been able to provide **Minimal Assurance** over the controls operating within the area under review because performance against target remained very poor, with less than 20% of assessments undertaken within the statutory timescales. There were regular delays at all key stages in the process, involving both Children's Services and the main provider.

1.21 Additionally, the monitoring information collected in the central tracker is not routinely used as a basis to improve performance or to report on overall performance. There are differences in the methodology used for calculating performance data by the council and the main provider, which diverts management attention away from addressing the key issues.

1.22 However, discussions are taking place with the CCG and the main provider to improve performance, and a LEAN project is reviewing the process with plans to change the delivery model of assessments being developed to speed up the process.

1.23 We agreed six actions with management, two of high priority, and will be undertaking a follow-up audit of this area as part of the 2019/20 annual audit plan.

Business Operations Cultural Compliance

1.24 Business Operations delivers HR and Finance transactional services on behalf of each of the councils within the Orbis partnership. The teams within Business Operations consist of:

- Procure to Pay (P2P);
- Income Allocation;
- Accounts Receivable;
- Employee Services;
- Recruitment Support;
- Direct Payments;
- ContrOCC Payments; and
- Pension Administration.

1.24 Our review looked to ensure that Business Operations as a service is delivered effectively and in compliance with all appropriate council policies and procedures, focusing on compliance with basic internal controls. The outcome of the audit was to provide assurance that key activities undertaken within the team are conducted in compliance with all policies and procedures, that robust management arrangements are in place and that all members of staff are subject to appropriate management and supervision.

1.25 Testing was undertaken in areas of policy including, but not limited to:

- Recruitment;
- Staff pay and allowances;
- Travel and expenses;
- Leave;
- Sickness absence;
- Performance and Development;
- Supervision;
- Code of conduct;
- Gifts and hospitality;
- Financial management; and
- Information governance.

1.26 We were only able to provide an opinion of **Partial Assurance** over the controls operating within the area under review because levels of non-compliance with council policies and procedures were found in the majority of areas reviewed.

1.27 Instances were found where additional allowances have been paid to members of staff within Business Operations without following council procedures and evidence of approval not being present. While variations in standard process can be accepted in unique circumstances, an audit trail and appropriate approval should still be maintained. This issue is of particular concern within Business Operations, as this service is responsible for processing HR transactional items for the whole council, and makes these issues unique to them as a service.

1.28 Other areas of non-compliance with council policies and procedures included no record being held of staff declarations for potential conflicts of interest, so management were unaware if potential conflicts existed. Only one of the new appointees within Business Operations reviewed had completed all of the compulsory training courses as required by the council's induction processes. Additionally, in the majority of cases, valid receipts were not being retained for both purchasing card transactions and business mileage claims. The failure to retain receipts is contrary to procedures and could result in the council being subject to financial penalty from HMRC.

1.29 We agreed a total of ten actions with management to secure improvement, and an action plan is in place to address the issues found. These will be subject to a future follow up by Internal Audit.

Annual Car User Lump Sum Payments

1.30 The annual car user lump sum (ACULS) is a payment made to council staff who are designated as contractual car users for business purposes. The payment has existed since 2008 and is paid in addition to the claims for miles travelled. Following unplanned audit work undertaken in April/May 2018 which reviewed aspects of expenses claimed by officers, it has become evident that there are control weaknesses and associated financial risks to the council surrounding the process for claiming ACULS payments. Total payment of ACULS exceeded £1m in 2017/18.

1.31 Following the Pay and Reward Review in July 2016, both contractual and non-contractual car users were eligible to claim ACULS if they were employed at the council before 1 July 2016 and their annual business mileage exceeded 1,500 miles. Those who joined (SCC) on or after 1 July 2016 were not eligible to claim ACULS.

1.32 The purpose of the audit was to provide assurance that key controls were in place to meet the following objectives:

- The policy on claiming ACULS is clear and has been communicated to all staff working for the council since the changes in July 2016;
- The procedures in place for claiming ACULS are robust with adequate controls and are applied consistently; and
- Managers and staff are clear about their responsibilities and entitlement to claim ACULS and are following the stipulated procedures.

1.33 A number of control and governance issues and weaknesses were identified within our audit. The revised (2016) Travelling Allowances and Expenses Policy is ambiguous and open to interpretation by officers, and its communication to staff has been ineffective. The policy is currently being reviewed and we have contributed to its update. Controls in operation within the eSuite form were considered so weak in this regard that they are not fit for purpose.

1.34 We identified that necessary checks on applications are not consistently undertaken by all managers, whilst the council is exposed to reputational and financial risk where checks are not consistently undertaken to identify valid driving licences and appropriate insurance are held.

1.35 Some officers (mainly contractual car users) have been paid at the highest band without actually having claimed any miles in the year at all, suggesting managers are not complying with the policy of annually reviewing the car user status.

1.36 An agreed action plan was put in place with management, and this will be an area to be followed up by Internal Audit in 2019/20. As a result of the findings, and the weaknesses within the internal control environment, we were only able to give an opinion of **Partial Assurance** in this area.

Rights Of Way

1.37 In Surrey there are around 3,500km of public rights of way. In its capacity as a local highway authority the council is responsible for the management and maintenance of this network and for meeting statutory duties set by central government. The total budget for this activity in 2018/19 is £640k.

1.38 The purpose of the audit was to provide assurance that key controls are in place to meet the following objectives:

- Statutory requirements set by central government are being met;
- Policies and procedures are in place to prevent negative impact to users and resulting negative publicity for the council; and
- Service delivery is risk based and ensures key areas are delivered within the available budget.

1.39 We were able to provide assurance that policies, processes and procedures were used consistently and compliantly by the service in the management of rights of way and controls over expenditure and the discharge of statutory duties (including maintenance and responding to public complaints or notifications) were operating effectively.

1.40 We provided three low priority actions to the service to further improve controls, focusing on the need to robustly challenge income targets to ensure their viability; to improve audit trails over customer complaints; and to improve transparency of work completed by contractors. Overall we were able to provide an opinion of **Substantial Assurance**.

Social Care Debt

1.41 The council provides a variety of Adult Social Care (ASC) services to residents. Some of these services are chargeable and the charging policy is set out in SCC's "Charging Policy for ASC Services" dated October 2016. Currently debt management activity is carried out by the Credit Control team. Financial assessments are carried out by Financial Assessments and Benefits Service. ASC management has recognised that debt management would be more effective if these two teams worked more closely together. Therefore, in February 2019, these two teams will be integrated and realigned to form a new "ASC Financial Assessment & Income Collection Service".

1.42 Charges raised in the twelve months up to October 2018 totalled £56.66m. At the end of October 2018, social care debt over one month old totalled £21.88m (net of credit balances totalling £0.91m). Of the £21.88m total debt, £8.77m was secured, and £13.11m was unsecured. 2,192 customers had total individual debt exceeding £10 over one month old. The highest individual sum owed was £584,000, a debt which is secured.

1.43 The purpose of the audit was to provide assurance that key controls were in place to meet the following control objectives:

- Prompt addition of new customers;
- Accurate recording of chargeable costs;
- Effective management of debt using suitable management information and KPIs;
- Prompt and accurate recording of receipts;
- Effective debt recovery;
- Processing and review of write-offs; and
- Processing and review of refunds and credit notes.

1.44 The audit identified a number of control issues and associated findings. Of the 53 cases referred to Legal Services, representing debt totalling £2.23m, there is a need for clearer visibility about the status of all cases and the likelihood of write-off.

1.45 Monthly debtor reports are accurate but analyses of results could be enhanced by the provision of commentaries and details of the main problem cases and the setting of specific targets for improved performance.

1.46 Case management reports do not currently indicate how long problem cases have been at issue, and the tracking of new customer cases (from initial referral through successive stages to final billing) cannot easily be monitored.

1.47 A new Debt Management handbook is being prepared by the Interim Head of Finance. ASC management need to liaise accordingly. Delegated authority levels for write-offs and refunds will need to be reviewed and confirmed.

1.48 The audit recognised that past difficulties in managing debt effectively and efficiently because of organisational communication limitations have been addressed by ASC management, and that much improvement to the control environment and operation of processes within it was evident. We were therefore able to provide an opinion of **Reasonable Assurance** in this area.

CFL Payment Cards

1.49 Children leaving care and transitioning into adults may be entitled to financial assistance from the council. This assistance includes “Independent Living Allowance” (ILA), a form of subsistence to cover living costs in lieu of benefits, and "Setting up Home Allowance" (SHA) to help a young person to live independently.

1.50 To be eligible for funding, the care leaver must have been in care for a cumulative total of 13 weeks starting after age 14 and ending after age 16. Each care leaver is supported by a Personal Advisor (PA) and has a care leaver's pathway plan covering all aspects of their transition to an adult, including financial considerations. Funds may be paid to the young person through a prepaid bank account provided by Prepaid Financial Services (PFS) under the council's corporate contract, or through a prepaid card provided by Allpay where there is a delay in opening a bank account.

1.51 Historically, prepaid cards were the only payment option for young people who were unable to open a bank account, such as asylum seekers with limited documentation, but PFS accounts are now available to all care leavers under the council's contract. However, since it can take several days to open a PFS bank account, prepaid cards are still in use. Between August 2015 and September 2018, just over 1,000 cards were issued with a total value of approximately £202,000.

1.52 This audit was undertaken as a result of risks over misuse of prepaid cards that had been identified in another Directorate during an irregularity investigation in 2017/18. The purpose of this audit was to provide assurance that key controls were in place to meet the following objectives:

- The storage of and access to new cards is appropriately managed;
- Public funds are only issued to young people and are not misappropriated; and
- Misuse of funds is identified in a timely manner and corrective action taken as necessary.

1.53 We were only been able to provide **Partial Assurance** over the controls operating within the area under review because of a number of key findings.

1.54 In the absence of any monitoring arrangements, management are almost completely unaware of how funds are being used and are therefore unable to identify potential issues. Management have given only limited consideration to the administration of prepaid cards, which may be at risk of misappropriation through becoming lost in the post or through false claims for funding being submitted by dishonest staff members.

1.55 Inconsistencies in the spelling of names has resulted in some care leavers being given up to four, concurrent cards, thus identifying a weakness in controls over card administration and issue and a risk that multiple cards could facilitate dishonest claims for funding. Additionally, we identified up to £15k of questionable spend over three years, as well a number of declined transactions of a concerning nature.

1.56 While of low relative value, the consequences of certain transactions could be significant such that the council may fail to meet its duties as a corporate parent, in particular where there are concerns around a young person's vulnerability or wellbeing. Without wishing to impose burdensome processes, and acknowledging that care leavers should not be made to feel singled out from their peers, basic checks could reduce the risk that young people are being manipulated by others to spend money, or that they are not receiving appropriate support.

Other Audit Work

Transformation Programme

1.57 The cumulative impact of demand growth and inflation, together with a reduction in central government funding, has resulted in the council's Medium Term Financial Plan (MTFP) identifying a budget gap of between £210m and £250m by 2021. To address this situation a number of business cases have been formulated to deliver and support change in Surrey, collectively known as the 'Transformation Programme'.

1.58 The Transformation Programme will run alongside other council projects in order to achieve its objectives, within an overarching Community Vision for Surrey in 2030. These other projects encompass the council's Organisational Strategy (how the council will work with residents and partners); the Preliminary Financial Strategy (which sets out a balanced budget for 2019/20 without the use of reserves); and Our People 2021' (the plan for the current and future workforce to achieve change within a high performance culture).

1.59 The benefits anticipated to be delivered through the Transformation Programme are £82m in 2019/20, rising to £124m in 2020/21. Investment costs to achieve transformation are subject to further refinement ahead of being presented to Council in February 2019 as part of the budget setting process, but are likely to be in the region of £26m through a mixture of both investment and opportunity costs in respect of current employees being used to deliver the projects.

1.60 The Transformation Programme is comprised of 6 thematic areas, underpinned by specific projects each of which has a Business Case as the basis for delivery plans:

Service Transformation (transforming services to sustainably meet residents' needs now and in the future)

Partnership and Integration (radically improving the way we work as one team with our partners)

New Ways Of Working (equipping our people with the practices and tools to do the best job)

Commissioning and Procurement (driving major savings and value for money)

Investment and Income (generating new and additional income and improving our use of capital)

Technology and Digital Innovation (adopting the processes, culture and technology of an internet era to drive improved outcomes)

1.61 The audit will be undertaken in phases to review processes and make any recommendations considered appropriate to ensure that suitable governance arrangements and procedures are in place to mitigate key risks. The proposed phases for the audit review will be:

- To provide assurance that key governance process, effective controls and risk management remain embedded within the overall Transformation Programme (phase 1);

And thereafter to ensure that the following agreed control objectives are in place:

- That key service operational, management and performance data held by Directorates and relied upon in the Business Cases is complete, accurate and reliable (phase 2);
- Effective systems remain in place to identify, record, mitigate and manage risks within project workstreams (phase 3);
- Gateway processes and controls are in place and working effectively within projects to provide assurance that key milestones and outcomes are on track and being delivered to budget and within expected timescales (phase 4); and
- Processes exist to identify potential control weaknesses that may arise with new working practices or system during the decommissioning of services or the transformation of existing services, and manage those weaknesses appropriately (phase 5).

1.62 Given the wide ranging scope of this programme, this audit will form the basis for the rolling assurance plan, which will be based on risks identified and/or level of control weakness assessed. In addition to the provision of ongoing advice and support in relation to risk, governance and internal control matters, feedback will be provided through a combination of audit reports, health check briefings or position statements at various stages of transformation across the projects. We will also seek to obtain regular updates on progress of projects through service liaison meetings which may also inform further testing. Regular updates on this work will be communicated to management during the audit.

Children's Care Assessments

1.63 Our review of this area has now reached draft report stage, with extended discussions ongoing with CFL senior management to finalise the paper.

1.64 The scope of the audit has been to ensure:

- Care package assessments and approvals are determined by clear procedures that are both statutorily compliant and effectively balance suitable provision of care need with cost;
- There are appropriate gateways for checking and approving packages of care to enable consistency, quality and value for money to be monitored;
- Appropriate mechanisms are in place in the commissioning and procurement of care packages once assessment is complete;
- There are effective processes to forecast ongoing and future care liabilities that provide management at Surrey County Council with reliable and accurate management information; and
- Ongoing review of care packages is mindful both of meeting the care need and of maintaining a sustainable budget.

1.65 Our initial findings were that numerous and significant control weaknesses existed in each of the areas reviewed. Of particular concern is the fact that many officers involved in this audit were aware of a range of issues, over a number of years in some cases, and yet, until recently, very little effort has been made to address these.

1.66 Ongoing work in CFL to address weaknesses in the control environment is extensive and fast-moving, and this in part has led to the original audit report being delayed in its finalisation. We anticipate bringing our work to a close with a formal report early in Quarter 4. After this our work will focus on the provision of advice and support on design of new processes being developed by the service.

Adults Care Assessments

1.67 We have almost concluded our fieldwork in reviewing care assessment processes within Adult Social Care. This extensive audit has been conducted across Quarters 2 and 3 and will report shortly.

1.68 Initial findings suggest that, while there are areas for improvement in each stage of the care assessment process, ASC management are aware of these and new ways of working have recently been introduced to address such issues.

Grant certification

1.69 We have completed the certification of grant returns for financial year 2018/19 for the council relating to:

- Troubled Families (Payment By Results) claim for the period October-December 2018.

2 Counter Fraud and Investigation Activities

Proactive Counter Fraud Work

Summary of Completed Investigations

2.1 We have completed two significant investigations in Quarter 3, which have taken over 50 days of audit resource to bring to the current position.

2.2 The first of these was in response to allegations of corruption and misconduct in a procurement exercise made via a whistleblowing. An extensive audit was undertaken which found no evidence of fraud or misconduct by individual officers. Weaknesses across the entire procurement exercise were, however, identified, both within the service in question and the Procurement function corporately. Actions have been agreed to address these weaknesses, and will be followed-up in the 2019/20 annual plan to ensure implementation has been effective.

2.3 The second major investigation was undertaken at a maintained school where a newly appointed Headteacher discovered some anomalies in the working and accounting practices of the school business manager. Internal Audit support with preliminary investigations subsequently led to a referral to the police, with whom the case is currently rests. Internal Audit will continue to support this as the case progresses.

2.4 We have also undertaken ad hoc work providing data analytics support to Early Years to identify potential duplicate funding of nursery places. The findings have been shared with the service and improvements identified to improve the administration of nursery funding.

3 Action Tracking

3.1 All high priority actions agreed with management as part of individual audit reviews are subject to action tracking. As at the end of Quarter 3, taking a rolling year into account, 100% of high priority actions due had been implemented.

4 Amendments to the Audit Plan

4.1 In accordance with proper professional practice, the Internal Audit plan for the year remains under regular review to ensure that the service continues to focus its resources in the highest priority areas based on an assessment of risk. Following discussions with management, one additional review has been added to the audit plan during the third quarter:

- Surrey Wildlife Trust.

4.2 Through the same process, audits could either be removed or deferred from the audit plan and, where appropriate, considered for inclusion in the 2019/20 plan as part of the overall risk assessment completed during the annual audit planning process. During Quarter 3, we have taken the opportunity to review available internal audit resources for the year in light of a recent staff resignation and some long term sickness absences within the service. Whilst we are proactively managing the situation and remain confident of being able to achieve sufficient coverage to provide the annual internal audit opinion, there remains a high risk that we will be unable to deliver all of the planned audit days by 31 March 2019. In such circumstances, it is necessary to re-prioritise our work and therefore the following audits have formally been removed/deferred from the plan:

- Officer Expenses;
- Street Lighting PFI;
- Public Health Commissioning.

5 Internal Audit Performance

5.1 In addition to the annual assessment of internal audit effectiveness against Public Sector Internal Audit Standards (PSIAS), the performance of the service is monitored on an ongoing basis against a set up agreed key performance indicators as set out in the following table:

Aspect of Service	Orbis IA Performance Indicator	Target	RAG Score	Actual Performance
Quality	Annual Audit Plan agreed by Audit Committee	By end April	G	Approved by Audit Committee on 12 April 2018
	Annual Audit Report and Opinion	By end July	G	2018/19 Annual Report and Opinion approved by Audit Committee on 26 July 2018
	Customer Satisfaction Levels	90% satisfied	G	100%
Productivity and Process Efficiency	Audit Plan – completion to draft report stage	90% (full year)	G	71.6% completed to draft report stage by end of Q3 (against a Q3 target of 67.5%)
Compliance with	Public Sector Internal Audit Standards	Conforms	G	January 2018 – External assessment by the South West Audit Partnership

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Aspect of Service	Orbis IA Performance Indicator	Target	RAG Score	Actual Performance
Professional Standards				gave an opinion of 'Generally Conforms' – the highest of three possible rankings
	Relevant legislation such as the Police and Criminal Evidence Act, Criminal Procedures and Investigations Act	Conforms	G	No evidence of non-compliance identified
Outcome and degree of influence	Implementation of management actions agreed in response to audit findings	95% for high priority agreed actions	G	100%
Our staff	Professionally Qualified/Accredited	80%	G	85%[1]

[1] Includes 1 part-qualified staff

Appendix B

Audit Opinions and Definitions

Opinion	Definition
Substantial Assurance	Controls are in place and are operating as expected to manage key risks to the achievement of system or service objectives.
Reasonable Assurance	Most controls are in place and are operating as expected to manage key risks to the achievement of system or service objectives.
Partial Assurance	There are weaknesses in the system of control and/or the level of non-compliance is such as to put the achievement of the system or service objectives at risk.
Minimal Assurance	Controls are generally weak or non-existent, leaving the system open to the risk of significant error or fraud. There is a high risk to the ability of the system/service to meet its objectives.

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